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# Feature Article

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## PROSPECTS FOR LOWLAND AIRPORTS AND AIR SERVICES

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### INTRODUCTION AND BACKGROUND

It is widely accepted that Scotland suffers from an over-provision of airport services. This is particularly acute in the case of the three Lowland airports where, in 1984-85, 4.55 million passengers utilised terminal facilities with an estimated capacity of 7.25 mppa. This outturn of 63% capacity utilisation conceals marked variations. In the last fiscal year Prestwick's terminal building operated at 15.5% capacity whilst Glasgow and Edinburgh operated at 79.5% and 76.5% respectively.

The prime reason for the unequal distribution of business between the Lowland airports is the policy of market segmentation adopted by successive administrations. Under national air service agreements, Prestwick is designated as the sole Scottish gateway for transatlantic services. In December 1982, British Midland Airways (BMA) attempted to overturn this policy by seeking an air transport licence permitting a Manchester-Glasgow-New York service. This was subsequently granted by the UK industry's regulatory body, the Civil Aviation Authority (CAA). However, Prestwick's owners, the British Airports Authority (BAA) appealed against this decision to the Secretary of State for Transport, Mr Nicholas Ridley, who upheld the BAA appeal in May 1984. Mr Ridley was dissatisfied with some of the issues raised by this episode and ordered a review of the present Lowlands airports policy to be conducted by a working party consisting of Scottish Office, Treasury, Department of Transport, BAA and CAA representatives.

The working party reported belatedly in March 1985. Their broad conclusion was that "the balance of financial and economic considerations would point to a change in policy which concentrated operations at Glasgow and Edinburgh". However, a set of wider offsetting costs were identified and the working party paved the way for the retention of the status quo by inviting final decision to be taken on the basis of "political priorities".

Thus, in early April Mr Ridley announced that "the Government have decided that for the present there should be no change in the policy under which Prestwick is designated as the gateway for long haul air services to and from Scotland". Referring to the poor operating and financial performance of the airport, Mr Ridley continued: "if however a change in the fortunes of Prestwick does not come about by 1989, the decision to maintain the existing policy will have to be reconsidered". Thus, the Government decided to maintain the present traffic distribution arrangements for Scotland. Activity at both Edinburgh and Glasgow continues to be restricted to domestic and short haul international scheduled and charter traffic whilst Prestwick remains virtually the sole Scottish airport allowed to handle transatlantic business.

In June 1984 the Government published its White Paper on Airports Policy in which it formalised these Scottish arrangements and outlined proposals for the privatisation of the BAA in 1987. It is fair to say that neither adherents of change nor supporters of Prestwick are satisfied with this outcome and the decision has not been greeted enthusiastically in Scotland. This has prompted a spirited defence of

the policy by Government ministers. It is Mr Ridley's view that "our proposals give Prestwick a new opportunity to thrive" and Mr Younger's contention that "there is no reason why Prestwick airport should not have a rosy future". Mr Younger asserted that "we now have a blueprint for development and for airport policy for a long time ahead. Now that a lengthy period of uncertainty is over, let us get on with the job of talking Prestwick up for the good of everyone."

It is our view that "uncertainty" is not at the root of Prestwick's troubles and that "talking Prestwick up" has not succeeded and is unlikely to make a material impact on the fortunes of Scotland's transatlantic gateway. Prestwick Airport suffers from fundamentally insoluble problems and its existence is threatened by, and is inconsistent with, Government policies towards air transport.

#### **The prospects for Prestwick airport**

Any understanding of the difficulties faced by Prestwick requires an appreciation of the liberal stance underpinning current civil aviation policy. International air-transport is closely regulated by bilateral air-service agreements (ASA's) which determine the nature and extent of competition on routes between the signatory nations. In many cases, only one airline from each country is permitted to supply air services and often price setting, quantity restraints and revenue pooling are called for in order to protect the less viable carrier. This had led to a high price-high quality service designed to cater for business and commercial interest at the expense of mass transport opportunities.

The Government is committed in practice as well as principle to re-negotiating ASA's to accommodate free access and in greater competition. In theory, such deregulation will lead to pressure on airline prices and costs and carriers will require to become more efficient through the elimination of loss making and marginal services. In such circumstances airlines will tend to operate through major hub airports whose interlining

opportunities present the prospect of higher load factors. Thus, liberalisation will favour airports whose location provides the basis for generating a viable network of services.

Deregulation is a fact for transatlantic services as the Bermuda II agreement is liberalising in both intent and effect. This has led to the growth of low cost, high density operations such as Peoples Express, Virgin Atlantic and the ill-fated Laker Airways. Price competition is keen and there have been periodic allegations of unfair practices by national carriers who have cross-subsidised predatory prices with the monopoly rents from non-liberalised operations. As predicted, operators have pruned marginal services as evidenced by the BA decision to withdraw from both Manchester and Prestwick in 1981.

In the case of Prestwick, no return of carriers is likely because Prestwick suffers locational disadvantages which prevent it developing as a hub airport. First, Prestwick has the fourth smallest catchment area of any international airport in Western Europe. Secondly, Prestwick is poorly connected to major Scottish centres of population through existing road and rail infrastructure. However, it is not clear that improvements in these amenities would substantially alter the prospects of the airport and Strathclyde Region should be wary of committing scarce capital resources to clearly unprofitable rail halt schemes. Thirdly, Prestwick has the handicap of being an air transport cul de sac without a network of domestic and European feeder services. Such a network exists in Scotland but is built around the more conveniently located airports at Glasgow and Edinburgh. Not only does this prevent similar facilities developing at Prestwick but the existence of these networks brings Prestwick into direct competition for transatlantic business with London, Manchester and major European hubs where the service is more frequent. Thus, actual and potential carriers from Prestwick face stiff competition from BA and BCal whose wide ranging marketing operations are designed to tempt Scottish transatlantic demand to patronise their domestic services and interline at English and Continental airports. In short, the existing traffic distribution policy does not maintain complementary

roles for Lowland airports since Glasgow and Edinburgh actually do compete for Scotland's transatlantic demand.

Transatlantic business at both Heathrow and Gatwick has recovered sharply in the past fiscal year reflecting favourable exchange rates and the rapid emergence of air transport from the recession of the early 1980's. Prestwick has failed to benefit from these recent favourable conditions. In the 1984-85 fiscal year the number of terminal passengers declined by 7.0% to 232,000 following a slight increase in the previous period. The decline is less marked in scheduled services than on charters who compete more directly for leisure business with the low price carriers. Terminal passengers are currently at about 60% of the levels experienced in the 1970's and scheduled passengers remain well below half of the number using the airport in the mid and late parts of the last decade. Prestwick continues to lose air transport movements. These are at present only one third as numerous as ten years ago. This collapse has been largely offset by the growth in the movements of General Aviation traffic.

The throughput of cargo and mail showed some signs of recovery this year, although these are at relatively low tonnages compared with the late 1970's. The financial position has improved slightly with the operating loss down by £600,000 to £2.8 million largely reflecting reduced depreciation provisions. Since it is questionable whether further scope is available for improvements though decreases in costs, any substantial reduction in losses requires to be found on the income side. There are three widely canvassed remedies:

**Reduced uncertainty:** It is the view of both Government and the BAA that uncertainty as to the airport's future has resulted in Prestwick failing to improve its performance in the face of ostensibly favourable conditions. Our analysis denies such propositions and suggests that it is the permanently more competitive transatlantic market in conjunction with poor locational characteristics that provide the insurmountable constraints to recovery. However, if uncertainty is a major difficulty, the recent Review and

White Paper have changed nothing and solved little. First, the airport is only guaranteed until 1989. Secondly, the BAA is to be privatised in 1987 and there is no indication that the Government will maintain the final say over the closure of the aerodrome as the BAA and most Scottish MP's desire. Given that one purpose of privatisation is to reduce such political intervention and given that Prestwick continues to divide public opinion, it seems unlikely that the Government would wish to retain such an inconsistent and thankless role. However, initially, the Government will maintain a large strategic holding which could be used to thwart early closure. In addition, the Government could refuse air transport licences for Glasgow routes and planning permission for physical expansions at other Lowland airports. Thus, the Government could force a privatised BAA to persist with Prestwick. Again this would hardly be consistent with the efficiency objectives of denationalisation.

It appears, therefore, that unless Prestwick's performance improves substantially, the shareholders of BAA plc will have every incentive to close the airport and realise the capital gains arising from the reduced losses and increased utilisation of existing facilities.

The Review of Lowlands Airports Policy endeavoured to demonstrate that under high and intermediate growth of demand it was not financially worthwhile for the BAA to close Glasgow. Whilst several of the assumptions can be questioned there is an extremely low probability of ever achieving either intermediate or high demand. Only the advent of new operations such as those proposed by Highland Express can hope to raise activity and result in net benefits to the owners from sustaining Prestwick.

**Highland Express:** This airline proposes to develop Prestwick as its base for transatlantic flights originating at Birmingham, Maastricht and Stansted. In its original plans the company envisaged a progressive build up to 140,000 terminal passengers at Prestwick with a further 400,000 transiting to and from the above

mentioned airports. The company has recently revised these projections upwards in the light of the sustained recovery in the transatlantic market.

The Highland Express strategy is based on cheap fares to tap the younger end of the leisure market and on a clear Scottish image designed to exploit the potentially vast 'kith and kin' demand. The 'youth' market is already well catered for by direct services at Gatwick and it is not clear how well indirect flights via Prestwick will fare. Potentially both Stansted and Birmingham serve a different catchment area to Gatwick and at present Highland Express would have the area to itself. However, Peoples Express have applied for a route licence to operate transatlantic from Stansted and this must call into question the viability of the Highland Express plans for that particular market. The 'kith and kin' business is currently served by Air Canada and North West Orient at Prestwick, by charters and indirectly via London and other international airports. As already indicated, any new services would face stiff competition from existing carriers whose marketing organisations are adept at capturing both direct and indirect Scottish transatlantic demand.

The proposed numbers of terminal passengers envisaged by Highland Express will be difficult to attain and it is a moot point whether the new airline will attract the financial and marketing resources which will be required in its growth phase. It is also likely that the new airline would attract custom from existing operators at Prestwick and there is tentative evidence to suggest that this could undermine the profitability of the two remaining scheduled carriers. North West Orient estimate that 20% of their demand is business-orientated and it is probable that Air Canada is broadly similar. Thus, Highland Express will be competing with both these carriers for the bulk of their already insubstantial business.

Analysis of terminal passengers per air-transport movement reveals that the ratios for Prestwick are substantially below those for Heathrow and Gatwick on North

American routes. Allowing for differences in aircraft mix, this suggests that operating transatlantic flights from Prestwick may be relatively fragile in financial terms. There is, therefore, a suspicion that if Highland Express were successful it would jeopardise the operations of the existing carriers. This would not provide any lasting security for the airport.

As yet Highland Express has obtained neither finance for aeroplanes nor a route licence for its operations and it is still not apparent that the airline will be ready for the revised 1986 launch. The Highland Express venture is innovative and risky but its effect on Prestwick's financial performance is uncertain. Given that BAA estimate that an additional 100,000 terminal passengers would result in the airport breaking even, it is likely that a successful outcome for Highland Express will be necessary but not sufficient to save Prestwick within a privatised BAA where higher returns on capital will be required. It is probable that a prosperous Highland Express will ultimately drive away one or both of the existing scheduled carriers because in a liberal operating environment there is simply not much likelihood that Lowland Scotland can support the required volume of transatlantic services to profitably sustain three carriers competing for seasonal leisure demand. In any event, there is no way that Scottish transatlantic demand can justify a separate airport which is what current policy effectively dictates.

**Twin-engined aircraft:** The possibility that the new generation of wide-bodied twin-engined jets such as the Boeing 767 will be licensed to fly transatlantic has implications for both Prestwick and other Lowland airports. The international civil aviation community remains divided on issues of safety but it seems likely that, following the stance taken by Canada, these planes will be in service over the Atlantic sooner rather than later. The economics of these aircraft favour a marginal destination and could result in increased frequency of services at Prestwick, thus countering the argument of the previous section. In addition, safety requirements may strengthen Prestwick's role as a diversionary airport.

Whilst such operations provide an opportunity for Prestwick they also present a threat. Such services could easily be based at Glasgow without implying substantial expenditure on infrastructure. This would make any closure option more attractive to BAA.

#### SUMMARY AND CONCLUSIONS

The main thrust of this paper is that liberalisation of air-services tends to favour airports where a strong and viable route network exists or is capable of being developed. The policy of segmenting Scottish long and short haul traffic in itself would deny Prestwick such development. In addition, Prestwick serves a market which is only barely capable of supporting transatlantic services. In the more liberal environment Prestwick is not capable of being "talked up" and indeed the Review makes the limitations of such a strategy very clear.

It is, therefore, fundamentally wrong to argue that Prestwick's development is being restricted by uncertainty.

However, even if this were true, the Review of Lowland Airport Policy and subsequent White Paper actually add to the uncertainty surrounding the airport.

Similarly, the advent of twin-engined jets cuts both ways. These offer no definite salvation for the Ayrshire airport. Thus Highland Express provides Prestwick's last faint hope of escaping closure in 1989. Given our analysis, it is unlikely that Highland Express can expand business sufficiently to make the airport an attractive proposition to the private sector. There seems little prospect that Highland Express can galvanise Prestwick in the way that Peoples Express transformed Newark. The twin problems of strong competing hubs and poor and seasonal local demand deny such optimism.

Thus Prestwick is a casualty of the very market forces the Government is committed to extending. To continue to prop up Prestwick subsequent to privatisation would contradict the fundamental objectives of the policy. For industries with structural problems, privatisation implies more than a painless transfer of assets between sectors. Infrastructure developed under a public sector regime may not prove robust to most exacting private sector criteria. Given the Government's explicit free market stance, the statements by Mr Younger and Mr Ridley are misleading and inconsistent. It is only a matter of time before the market realities overtake the empty rhetoric and the costs become apparent. The Government is committed to creating a world where Prestwick airport has little future and in the 1990's transatlantic services will be based at Abbotsinch.